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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re: LEEWARD HOTELS, L.P., an Arizona Limited Partnership, Debtor.	In Proceedings Under Chapter 11 Case No. B-99-09162 ECF-GBN **OBJECTION TO APPROVAL OF DEBTOR'S DISCLOSURE STATEMENT DATED OCTOBER 29, 1999** **Date of Hearing: January 10, 2000** **Time of Hearing: 10:00 a.m.**

LASALLE NATIONAL BANK, in its capacity as Trustee for the registered holders of DLJ Mortgage Acceptance Corporation, Commercial Mortgage Passthrough Certificates, Series 1997-CF1, by and through its Servicer, Lennar Partners, Inc. (the "Secured Lender") hereby objects to the adequacy of "Debtor's Disclosure Statement," dated October 29, 1999 (the "Disclosure Statement"), filed by LEEWARD HOTELS, L.P. , debtor and debtor-in-possession ("Debtor"). The Disclosure Statement states: "It is anticipated that this will be a 'full pay' plan." Disclosure Statement at 13. Creditors will vote on this representation. This Disclosure Statement is so inadequate (and indeed does not support this statement) as to border on intentionally misleading (as demonstrated herein).

Request For Preliminary Determination On Plan Confirmability.

As a preliminary matter, this Court should consider as a threshold issue the facial non-confirmability of the Plan of Reorganization (the "Plan") filed in conjunction with the Disclosure

Statement under controlling Supreme Court and Ninth Circuit authority. Specifically, the Debtor's Plan, by its own projections, is not a full payout plan pursuant to Bankruptcy Code § 1129(b)(2)(B)(i) and because the Debtor is the only party that has an opportunity to propose a plan, the Plan on its face is "doomed" pursuant to the Supreme Court's decision in *In re 203 North LaSalle Partnership*, ___ U.S. ____, 119 S. Ct. 1411 (1999) ("*203 North LaSalle*"). The Secured Lender recognizes that this Court does not normally take confirmation issues at the disclosure statement phase of a proceeding, but the facial unconfirmability of the Debtor's Plan in light of controlling Supreme Court authority requires this Court, in the interest of judicial economy and efficiency, to spare the estate and the Secured Lender the expense of going through a contested confirmation hearing when the Debtor's Plan, on its face, violates the rule of law laid down by the United States Supreme Court in *203 North LaSalle*. *See* pages 6 through 10, *infra*.

Eight (8) Deficiencies In The Disclosure Statement.

Alternatively, the Secured Lender respectfully submits that the Disclosure Statement is deficient and does not contain "adequate information" as required by Bankruptcy Code § 1125(a) in at least the following eight (8) areas:

1. GMAC Settlement. The Disclosure Statement must disclose the impact on creditor recoveries resulting from the GMAC settlement (*see* pages 12, *et seq.*, *infra*).

2. Risk Factors. The Disclosure Statement must disclose the risk factors inherent in distributions to creditors from operations, potential postconfirmation sales, potential termination of the new franchise agreement, and recoveries of potential preferences (*see* pages 13 *et seq.*, *infra*).

(a) There is no discussion of risks associated with postconfirmation operations and projected cashflows and how these impact the "full payout";

(b) There is no discussion of the risks associated with the sale or refinance of the hotels in 2007;

(c) There is no discussion of the impact on unpaid claims of sales of hotels at the "Release Prices";

(d) There is no discussion of any risks associated with collection of the potential "Preference Recovery Pool"; and

(e) The Disclosure Statement must disclose the impact of a termination of the Best Franchising agreement and its impact on creditor recoveries.

3. Misleading Projections. The Disclosure Statement's Projections are misleading in 5 respects and must be supplemented (*see* pages 18 *et seq., infra*).

(a) The 1999 figures should be stated as actual and not projected;

(b) The Debtor must disclose and specifically set forth all assumptions for the projections;

(c) The Projections materially understate the total Secured Lender's secured and unsecured claims;

(d) The Disclosure Statement must disclose the Debtor's analysis as to the value of the Secured Lender's seven Hotels in 2007 (when balloon payments are due); and

(e) The Projections do not properly account for or allocate the Secured Lender's claims on a hotel by hotel basis.

4. Release Price Information. The Disclosure Statement is misleading and contradictory with respect to the "Release Prices" and post-confirmation sales provisions (*see* pages 25 *et seq., infra*).

(a) There is no disclosure as to how the Release Prices were calculated;

(b) Why are Release Prices provided for 3 Hotels being returned to the Secured Lender?;

(c) What is the impact on creditors if sales are consummated at Release Prices?;

(d) What impact will the Release Prices have on the Best Financing loan?; and

(e) What, if any, are the Secured Lender's credit bid rights?

5. Classification. The Disclosure Statement must provide more disclosure on classification and reasons for disparate treatments (*see* pages 28 *et seq., infra).*

(a) The Disclosure Statement needs to disclose the basis for classification of claims;

(b) The Disclosure Statement needs to disclose the basis for subordination of the Secured Lender's unsecured claim; and

(c) The Disclosure Statement needs to disclose the basis for less favorable interest rates to the Secured Lender than to Amresco.

6. Pre-Bankruptcy Events. The Disclosure Statement must more accurately and fully disclose prebankruptcy events (*see* pages 29 *et seq., infra).*

7. Information Regarding The "Capital Infusion". The Disclosure Statement must more accurately disclose the full terms and conditions of the so-called "capital infusion" (*see* pages 36 *et seq., infra).*

8. Executory Contracts. The Disclosure Statement must disclose more information about the Kilburg Management contract (*see* pages 37 *et seq., infra).*

(a) Why is the Debtor assuming the Kilburg Management contract for three (3) hotels that it is returning to the Secured Lender?;

(b) What efforts did the Debtor make to shop the Kilburg Management contract before deciding to assume it?; and

(c) What claim will Kilburg Management have if it is terminated as part of the sale of the Albuquerque Hotel encumbered by Amresco?

This Objection is supported by the attached Memorandum Of Points And Authorities, as well as the entire record before this Court, all of which are incorporated by this reference herein.

RESPECTFULLY SUBMITTED this 3rd day of January, 2000.

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MEMORANDUM OF POINTS AND AUTHORITIES

I. FACTUAL AND PROCEDURAL HISTORY.

1.1 The Debtor filed its voluntary petition under Chapter 11 on August 2, 1999. The Debtor is currently the debtor and debtor-in-possession in this Chapter 11 case.

1.2 The Debtor filed the Disclosure Statement (with accompanying Plan) on October 29, 1999. On November 15, 1999, the Secured Lender filed the "Secured Lender's Motion To Modify Exclusivity Pursuant To Bankruptcy Code § 1121(d)" (the "Exclusivity Motion"), which Motion is set to be heard on January 10, 2000 at the same time as the approval of the Debtor's Disclosure Statement. The Debtor, by and through its counsel, has consistently refused to agree to modify or terminate exclusivity to allow the Secured Lender to file its own competing plan in this case.

1.3 Under the Debtor's Plan, the Secured Lender is dealt with as a secured creditor in Class 2-N, and a general unsecured creditor in Class 3-B. As to the Secured Lender's unsecured claim in Class 3-B, the Secured Lender is the only creditor in that class. The Secured Lender affirms and avows to the Court that it intends to reject the Debtor's Plan both as a secured and unsecured creditor, thereby putting the confirmation of this Plan into a "cramdown" posture pursuant to Bankruptcy Code § 1129(b)(2)(B).

1.4 The Plan provides that the existing general and limited partners of this Debtor will retain their partnership interests in the Debtor.

1.5 The Debtor has refused to terminate or modify exclusivity in this case.

II. THE DEBTOR'S PLAN IS FACIALLY UNCONFIRMABLE AS IT VIOLATES CONTROLLING U.S. SUPREME COURT AUTHORITY.

1. The Court Should Consider Whether This Plan Is Facially Unconfirmable.

While the Secured Lender recognizes this Court does not usually entertain confirmation objections as part of disclosure statement hearings, the Debtor's Plan is facially unconfirmable in light of controlling United States Supreme Court authority as well as controlling Ninth Circuit Court of Appeals authority. To allow solicitation of this Disclosure Statement to proceed would be a tremendous waste of judicial time and the estate's clearly limited resources.

Courts are increasingly more willing to entertain confirmation objections at the hearing on approval on approval of the disclosure statement where the plan, on its face, cannot be confirmed. Specifically, in *In re Dakota Rail, Inc.*, 104 B.R. 138 (Bankr. D. Minn. 1989), the bankruptcy court denied approval of the disclosure statement and reasoned that:

> [w]here the disclosure statement on its face relates to a plan that cannot be confirmed…the court [has] an obligation not to subject the estate to the expense of soliciting votes and seeking confirmation of the plan; otherwise, confirmation issues are left for later consideration. Allowing a factually nonconfirmable plan to accompany a disclosure statement is both inadequate disclosure and a misrepresentation.

Id. at 143. *Accord In re Eastern Maine Electric Cooperative, Inc.*, 125 B.R. 329, 333 (Bankr. D. Me. 1991) (Court must take two-step approach to disclosure statements: first, court should determine whether disclosure statement relates to plan that is so "fatally flawed" that confirmation is "impossible"; second, if plan is not "fatally flawed," then court can spend time considering adequacy and accuracy of the disclosure statement.). *See also In re Market Square Inn, Inc.*, 163 B.R. 64, 68 (Bankr. W.D. Pa. 1994) (When a plan is clearly not capable of confirmation, court may refuse to approve disclosure statement); *In re H.K. Porter Co.*, 156 B.R. 16 (Bankr. W.D. Pa. 1993) (Court may refuse to approve a disclosure statement for a plan that is plainly not feasible.); *In re 266 Washington Associates*, 141 B.R.

275, 288 (Bankr. E.D.N.Y. 1992) (Disclosure statement will not be approved if it describes a plan that is facially flawed and incapable of confirmation.); *In re Valrico Square Ltd. Partnership*, 113 B.R. 794, 796 (Bankr. S.D. Fla. 1990) ("Soliciting votes and seeking court approval on a clearly fruitless venture is a waste of the time of the Court and the parties."); *In re Cardinal Congregate I*, 121 B.R. 760, 764 (Bankr. S.D. Ohio 1990) (Disclosure statement relating to facially unconfirmable plan should not be approved.); *In re Copy Crafters Quickprint*, 92 B.R. 973, 980 (Bankr. N.D.N.Y. 1988); *In re Pecht*, 53 B.R. 768, 772 (Bankr. E.D. Va. 1985) (Court should not approve a disclosure statement for a plan that cannot be confirmed.); *In re McCall*, 44 B.R. 242, 243 (Bankr. E.D. Pa. 1984).

2. The Debtor's Plan Violates *203 North LaSalle*.

It is beyond dispute that this Debtor's Plan, certainly as to the Secured Lender's unsecured claim found in Class 3-B, will be in a cramdown posture under Bankruptcy Code § 1129(b)(2)(B). While the Debtor frequently asserts that this is in the nature of a "full payout" Plan, in fact a review of the Disclosure Statement indicates that over the seven year life of the Plan, the Secured Lender's Class 3-B claim (even at an understated amount),[1] will have an unpaid amount at the end of 2007. *See* Exhibit "F" to the Disclosure Statement, showing approximately $103,000.00 will be left unpaid by December 31, 2007 even under the Debtor's projected cashflows.[2]

The Plan is styled as a "new capital" plan in an effort to enable confirmation notwithstanding the fact that the Secured Lender's unsecured Class 3-B claim is not being paid in full.[3] The Plan has been proposed and is being prosecuted within the Debtor's exclusivity period pursuant to Bankruptcy Code §

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[1] *See* Section IV(3)(c) at page19, *infra*.

[2] Moreover, even assuming that there was not an unpaid amount at the end of the seven years under the Plan, the interest rate proposed under the Plan for the Secured Lender's Class 3-B unsecured claim (*i.e.* the lesser of six percent (6%) per annum or the federal judgment rate) does not satisfy the present value requirement of Bankruptcy Code § 1129(b)(2)(B). The prime rate is at 8 ½ percent, and a rate of 6% cannot possibly provide the market rate required by *In re Fowler*, 903 F.2d 694 (9th Cir. 1990) and *In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d 1503 (9th Cir. 1987). Of course, if the present value of an objecting class' debt is not promised by a plan, it cannot satisfy the "full payout" requirement for cramdown under Bankruptcy Code § 1129(b)(2)(B)(i). *See In re Perez*, 30 F.2d 1209 (9th Cir. 1994).

1121(d), and indeed the Debtor has affirmatively rejected any modification of exclusivity in this case to allow the Secured Lender to file its own plan. As a result, the Secured Lender had to file its Exclusivity Motion which is set to be heard on January 10, 2000.

In May of 1999, the United States Supreme Court rendered its long-awaited decision in *203 North LaSalle*. Notwithstanding filing this Plan nearly five months after the Supreme Court's pronouncement in *203 North LaSalle*, the Debtor chose to file a plan that is in direct contradiction to the mandate given in that case. In the words of the United States Supreme Court:

> [The debtor's plan] is doomed, we can say without necessarily exhausting its flaws, by its provision for vesting equity in the reorganized business in the debtor's partners without extending an opportunity to anyone else either to compete for that equity or to propose a competing reorganization plan.

203 North LaSalle, 119 S. Ct. 1411, 1422 (1999).[4] Notwithstanding the clear dictate of the United States Supreme Court, the Debtor is proposing a Plan which would vest 100% of the equity in the reorganized Debtor in the Debtor's existing partners without allowing any other party to file a competing plan. What is even more interesting (and telling as far as what is motivating this particular Debtor) is that unlike other "new value" plans in which old equity contributes an out-of-pocket, at-risk equity infusions, the so-called "capital infusion" in this case is nothing more than a loan from a potential franchisor which must be paid in the event that the franchise agreement to be entered into with the new franchise company (*i.e.* Best Franchising, Inc.) is terminated after confirmation. This repayment obligation is secured by a junior lien on the assets of the reorganized Debtor. *See* Plan at page 10. *See also* Disclosure Statement, Exhibit "G" (a copy of a letter outlining the terms of the loan to the Debtor).

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[3] In fact, this is not a "new value" plan because the so-called "capital infusion" is nothing more than a loan which is to be secured by the assets of the reorganized debtor. *See* Section IV(7) at page 36, *infra*.

[4] The recitation herein of confirmation objections with respect to the Debtor's Plan is not intended to be an exhaustive list of all of the infirmities of this Plan, but only selected ones which the Secured Lender believes can and should be addressed as part of the Disclosure Statement process in order to avoid unnecessary expenditure of fees on behalf of all parties.

Interestingly, the Plan provides that the only flesh and blood individual connected with the Debtor and all equity holders, Mr. William Kilburg, will obtain this money from Best Franchising, and then use it strictly for refurbishment of six hotels. Thereafter, Mr. Kilburg will "guarantee" this loan. *Id.*

3. The Debtor's New Capital Is Insufficient As A Matter Of Controlling Law.

Even assuming, *arguendo*, that the Debtor's Plan did not violate the Supreme Court's decision in *203 North LaSalle*, it also blatantly violates controlling Ninth Circuit authority on what constitutes "new value." In this particular case, the so-called "capital infusion" is not coming from Mr. Kilburg, but rather is being made in the form of a loan from Best Franchising ("Best") to refurbish six (6) hotels that will be reflagged under a franchise agreement between the Debtor and Best. Indeed, none of the old equity holders in this Debtor (consisting of a general partner and twelve limited partners) are contributing anything in the nature of new cash. As the Ninth Circuit stated very clearly in *In re Ambanc La Mesa Limited Partnership*, 115 F3d 650, 654-655 (9th Cir. 1996):

> *The relevant amount for the substantiality analysis is the partner's up front contribution.* Under the "money or money's worth" requirement, the new capital contribution by the former equity holders (1) must consist of money or property which is freely traded in the economy, and (2) must be a present contribution, taking place on the effective date of the Plan rather than a future contribution. *See In re Yasparro*, 100 B.R. 91, 96-97 (Bankr. M.D. Fla. 1989) (holding that promissory notes from the individual debtor to the unsecured creditors were future rather than present contributions and thus did not satisfy the new value corollary) (citing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S. Ct. 963, 99 L. Ed. 2nd 169 (1988); *In re Stegall*, 85 B.R. 510 (C.D. Ill. 1987), *aff'd.*, 865 F.2d 140 (7th Cir. 1989)). *Only those contributions from Ambanc's partners that will actually be paid on the effective date of the plan may be considered as money or money's worth under the new value corollary….*

Id. at 654-655 (emphasis supplied).[5] A guaranty of a loan is not an "up front" capital infusion by anyone, much less the equity holders in the Debtor. *See In re Kham & Nate's Shoes No. 2, Inc.*, 908

[5] The contrived nature of the so-called "capital infusion" in this case is precisely the sort of thing that the Bankruptcy Court was concerned with in *In re Tallahassee Associates, LP*, 132 B.R. 712, 717 (Bankr. W.D. Pa. 1991) when it stated:

F.2d 1351, 1361 (7th Cir. 1990) ("Guaranties [by old equity] are no different [than promises of future labor]. They are intangible, inalienable, and unenforceable…. The [old equityholders] may revoke their guarantees or render them valueless by disposing of their assets…. Guarantees have 'no place in the asset column' of a balance sheet."). This particular "guarantee" is even less of a contribution as it is secured by the reorganized Debtor's assets. It is in all respects a "leveraged buy out." When taken in conjunction with the fact that this Debtor acquired its ownership interests in the various hotels in which it now owns for no out-of-pocket, at-risk capital, and indeed Mr. Kilburg himself acquired his interest in all of the entities that owned these hotels for no out-of-pocket, at-risk capital (*see* Section IV(6) at page 29, *infra*), it is apparent that this Debtor is seeking to perpetuate a continued retention of ownership interests and assets in which it will not currently have, nor did it ever have, any out-of-pocket, at-risk equity.

As such, the Plan is unconfirmable on its face as a matter of law under controlling United States Supreme Court and Ninth Circuit authority. This Court should not require the Secured Lender to go through a contested confirmation battle on a Plan that is on its face not confirmable and is being proposed for the tactical and economic benefit of Mr. Kilburg and his entities.

III. STANDARDS FOR DISCLOSURE.

It is axiomatic that the purpose of a disclosure statement is "to inform equity holders and claimants, as fully as possible, about the probable financial results of acceptance or rejection of a particular plan." *In re Stanley Hotel, Inc.*, 13 B.R. 926, 929 (Bankr. D. Colo. 1981). The provisions of Chapter 11 "force the debtor to provide complete disclosure and quantification of all liabilities against the estate so that a meaningful reorganization plan can be negotiated and confirmed." *In re Diberto*, 164

> A rigorous showing as to these [new value] requirements is necessary in order to ensure that a debtor's equity holders do not eviscerate the absolute priority rule by means of a contrived infusion.

B.R. 1, 4 (Bankr. D. NH 1993). "The Bankruptcy Code and the courts have placed the obligation to ensure full disclosure on the debtor in possession, not the creditors." *Cleasby v. Security Federal Savings Bank*, 794 P.2d 697, 701 (Mont. 1990).

"Adequate information" is defined in Bankruptcy Code § 1125(a)(1) as:

> Information of a kind, and in sufficient detail, as far as is reasonably practical…that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan….

Bankruptcy Code § 1125(a)(1). Several courts have attempted to develop a checklist of the required provisions to be included in a disclosure statement in order to meet the adequate information standard. *See In re Malek*, 35 B.R. 443 (Bankr. E.D. Mich. 1983); *In re Metrocraft Publishing Services*, 39 B.R. 567 (Bankr. N.D. Ga. 1984).

With respect to the *Malek* factors, that court denied approval of a disclosure statement and set forth the following minimum requirements against which the adequacy of a disclosure statement should be measured:

> **1. Description Of The Business:** The debtor must furnish information describing the nature of the business being reorganized under Chapter 11. This analysis must include the competitive conditions in the industry and the debtor's role in that industry…
>
> **2. A History Of The Debtor Prior To Filing:** The Chapter 11 debtor should describe, in detail, its activities before filing, including the reasons for filing the Chapter 11. This history should be provided in a neutral, objective and non-inflammatory manner….
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> * * *
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> **5. Execution Logistics:** The disclosure statement must describe how the plan is to be executed.
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> **8. Projection Of Operations:** The debtor should provide the projection of operations subsequent to confirmation so that the court may determine the feasibility of the plan. ***The debtor is required to make a full, clear, and complete disclosure of all underlying assumptions. The debtor must provide sufficient financial information to determine if the projections for operations subsequent to confirmation are feasible. If***

> ***the plan assumes an increase in income, the basis for this assumption must be set forth. If the future operations contain a risk of loss of income or anticipated financial instability, the factors that may cause a loss or diminution of income should be set forth.***
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> * * *
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> **10. Transaction With Insiders:** ***The disclosure statement must describe fully, completely and in detail all transactions with insiders***. If there are not such transactions, the debtor must so state.

In re Malek, 35 B.R. 443 at 443-44 (emphasis supplied).

Moreover, Bankruptcy Judge Drake added to the foregoing *Malek* factors the following: (1) "information relevant to the risks posed to creditors under the plan"; and (2) "the actual or projected realizable value from recovery of preferential or otherwise voidable transfers." *In re Metrocraft Publishing Services, Inc.*, 39 B.R. at 568.

As is set forth with specificity below, the Debtor's Disclosure Statement in this particular case falls far short of any acceptable standard of adequacy of disclosure under Bankruptcy Code § 1125 or applicable caselaw.

IV. EIGHT SPECIFIC AREAS WHERE DISCLOSURE MUST BE PROVIDED, SUPPLEMENTED, OR MATERIALLY REVISED.

The Debtor's Disclosure Statement is deficient in eight (8) areas, as follows:

1. Impact Of The Settlement With GMAC Commercial Mortgage Corporation.

The Debtor has entered into a settlement with GMAC Commercial Mortgage Corporation ("GMAC") which provides for the return of the Lubbock Hotel (on which GMAC has a first lien), and also settles a potential preference cause of action which the Debtor in its Disclosure Statement estimated would return approximately $100,000.00 to be used to pay unsecured creditors. *See* "Motion To Approval Settlement Agreement With GMAC Commercial Mortgage Corporation" filed on December 21, 1999; Disclosure Statement at 8, 19 (Classes 3-D and 3-E are to be paid from the "Preference Recovery Pool"); Disclosure Statement, Exhibit "F" ("Plan Cash Flows" showing payment in full of

Classes 3-D and 3-E of $650,000.00 from the "Preference Recovery Pool" in 2001). The Debtor's Disclosure Statement estimates that it will recover $550,000.00 in preferences from the Secured Lender, and another $100,000.00 from GMAC. Even assuming, *arguendo*, that the Debtor will be completely successful with respect to the alleged preference recovery from the Secured Lender (which it will not—*see* Section IV(2)(d) at page 15 *infra*), by the very nature of the GMAC settlement there would be a maximum of $550,000.00, not $650,000.00 in the "Preference Recovery Pool" to pay creditors in Classes 3-D and 3-E.

Accordingly, the Debtor's Disclosure Statement and projections must be modified to account for the impact on creditors of the GMAC settlement.

2. The Debtor's Disclosure Statement Must Disclose Risk Factors Which Will Impact Creditor Recoveries.

A creditor reviewing the Debtor's Disclosure Statement is given the impression that this is a full payout Plan. Indeed, the Disclosure Statement states: "It is anticipated that this will be a 'full pay' plan." Disclosure Statement at 13. Specifically, creditors in Classes 3-A, 3-D and 3-E would be led to believe that they will be paid 100% plus interest by December 31, 2001 from "net cashflows" as well as the "Preference Recovery Pool." Moreover, the Secured Lender's secured claim in Class 2-N and the unsecured claim in Class 3-B would appear to have substantial payout from net cashflows from the retained hotels through December 31, 2007. *See* Disclosure Statement, Exhibit "F". What is missing is any discussion at all with respect to any risk factors that would impact payments to creditors under the Plan.

(a) There Is No Discussion Of Risks Associated With Projected Cashflows.

This is particularly noteworthy because the particular hotels that will be producing the "net cash" necessary to pay creditors in these cases produced a combined negative net cashflow for 1999 of over $675,000.00. *See* Exhibit "1" attached hereto showing the net cashflows for the eight retained hotels in

1999, and comparing what the Debtor projects for calendar year 2000—a positive increase in net cashflow of nearly $818,000.00. ***Obviously, to the extent that there are insufficient cashflows from the hotels, or frankly even if the hotels perform as they did in 1998 and 1999, creditors will receive zero recovery or minimal recovery on their claims.*** *See also* discussion on the projections contained in Section IV(3) at page 18, *infra*.

(b) <u>There Is No Discussion Of The Risks Associated With The Sale Or Refinance Of The Hotels In 2007</u>.

Moreover, in order for the Debtor to be able to make the "full payment" on the Secured Lender's secured claim in Class 2-N as well as the Secured Lender's unsecured claim in Class 3-B, there will be a "balloon payment" which will be due on December 31, 2007. The Disclosure Statement merely states that on the "Maturity Date" (*i.e.* 12/31/07), there will be a sale or refinance of the hotels.

This Disclosure Statement needs to disclose what will happen to unpaid claims in 2007 if it is unsuccessful in "selling or refinancing" these hotels by December 31, 2007. By the Debtor's own projections, there will be approximately a $12.4 million balloon payment on the Secured Lender's Class 2-N secured claim (which is an understated amount—*see* Section IV(3)(c) at page 19, *infra*), as well as approximately $103,000.00 due and owing on the Secured Lender's Class 3-B unsecured claim (again, which is understated—*see id., infra*). What are the risk factors to the creditors if the Debtor is unable to meet its cashflows and/or sell or refinance the hotels by December 31, 2007? What does the Debtor estimate the values of the seven hotels will be in 2007? What is the basis and support for that belief? What happens to unpaid claims if the Debtor is unable to sell or refinance the hotels in 2007? The Debtor's Disclosure Statement must disclose these risk factors.

(c) <u>There Is No Discussion Of The Impact Of Sales For "Release Prices" On Unpaid Claims</u>.

The Debtor's Plan provides for "Release Prices" that the Debtor will be empowered to sell the seven hotels secured by the Secured Lender's liens, which sales can occur at any time during the seven year life of the Plan. *See* Disclosure Statement at 14-15, and Exhibit "H". While there is no basis for how the Debtor arrived at the "Release Prices" (*see* discussion in Section IV(4) at page 25, *infra*), there is also no discussion in the Plan as to what would happen to unpaid claims if the Debtor were to sell any or all of the hotels for the "Release Prices" set forth in the Disclosure Statement. What would happen to unpaid unsecured claims? Would the "Release Prices" produce sufficient cash to make any payment to unpaid unsecured creditors? Indeed, would the "Release Prices" provide sufficient net proceeds to even take care of the Secured Lender's allowed secured claim(s) with respect to the particular hotel(s) being sold? By the Secured Lender's calculations, the Release Prices will be insufficient to pay the balloon payment on the Secured Lender's allowed secured claims even in 2007 on at least five of the seven hotels. *See* Section IV(4) at page 25, *infra*. Will the Secured Lender have a right to credit bid its secured claim? Will a sale for a Release Price necessarily include an assumption of the Kilburg Management management contract? If not, will this create yet more postconfirmation debt? There is no discussion at all with respect to the impact of a postconfirmation sale for the "Release Price" set forth in the Disclosure Statement.

(d) <u>There Is No Discussion Of Any Risks Associated With The Potential "Preference Recovery Pool</u>."

At least two classes of unsecured creditors must look solely to the so-called "Preference Recovery Pool" for their recovery. *See* Disclosure Statement at 14, treatment of Classes 3-D and 3-E. There is no discussion as to: (i) what the anticipated amount of attorneys' fees to litigate the potential preference against the Secured Lender (again, since the GMAC settlement effectively settles any and all

preference litigation against GMAC); and (ii) why the Debtor believes it has a preference action against the Secured Lender. In essence, the Disclosure Statement seems to assume that the Secured Lender will simply hand over $550,000.00 in alleged preferences by calendar yearend 2000, and all that money will go to pay creditors in Classes 3-D and 3-E. There is no discussion of the cost to litigate those preferences, nor why the Debtor believes there are preferences against the Secured Lender.

This is not an academic issue. The Debtor asserts that it paid the Secured Lender $550,000.00 within the 90 days prior to the filing of the Chapter 11 on August 2, 1999. That 90-day period would cover the period of May 3 through August 2, 1999. In fact, this Debtor did not make any payments to the Secured Lender during that time period. ***The Secured Lender received eleven (11) payments totaling $550,000.00 in that 90-day period, and not a single one of those payments came from this Debtor.*** As set forth more specifically on Exhibit "2", $50,000.00 was paid by the general partner of the Debtor (Kilburg Hotels, LLC); $150,000.00 was paid by Abilene Inn Hotel, LP (one of the limited partners of this Debtor); $250,000.00 was paid by Abilene Holiday Hotel, LP (yet another limited partner of this Debtor); and $100,000.00 was paid by Ottawa Hotel, L.P. (yet another limited partner of this Debtor). Moreover, even if the payments were property of this Debtor, by the Debtor's own admission the Secured Lender was fully secured or over-secured by the first deed of trust lien against the Abilene Ramada Inn (owned by Abilene Inn Hotel, LP, which provided $150,000.00 of the prepetition payments) and the Abilene Holiday Inn (the source of payments of $250,000.00 wire transferred by Abilene Holiday Hotel, LP). It is axiomatic that a fully or over-secured creditor cannot receive a preference since it is not receiving more than it would receive in a Chapter 7 case.

As such, of the $550,000.00 in alleged preferences (which are necessary in order to make any distribution to unsecured creditors in Classes 3-D and 3-E), the Secured Lender believes that there was never any transfer of property of this Debtor, but rather it received payments from the general partner

and three limited partners of this Debtor. Moreover with respect to the payments from Abilene Inn Hotel, LP and Abilene Holiday Hotel, LP, the Secured Lender was fully or over-secured with respect to the loans secured by those particular hotels. Moreover, since at no time was this Debtor ever specifically indebted to the Secured Lender, these were not payments made on account of an antecedent debt. Indeed, the Secured Lender did not even know of the existence of this Debtor entity until five (5) days before the filing of this Chapter 11 case. *See* Section IV(6)(c) at page 32, *infra*. Finally, the payments that were received prior to the bankruptcy were for and on account not of any antecedent debt, but rather on account of a forbearance that had been negotiated between the parties. The Secured Lender did, in fact, postponed foreclosure sales with respect to the various hotels based upon receipt of the payments that formed the purported basis of the preferences.[6]

As such, while the Disclosure Statement assumes, without discussion of any risk analysis or analysis of what it will cost to litigate these alleged preferences, that it will have $650,000.00 worth of a "Preference Recovery Pool" to pay Class 3-D and 3-E unsecured claims in full, in fact $100,000.00 of this alleged "Preference Recovery Pool" has been settled, and with respect to the other $550,000.00 that litigation will be vigorously defended by the Secured Lender. The Disclosure Statement must contain a discussion of risk factors with respect to that and its impact on recoveries to creditors.

(e) <u>There Is No Disclosure Of Risk Related To The Termination Of The New Franchise Agreement</u>.

As set forth in Section IV(7), at page 36, *infra*, very little specific information is given regarding the specific terms of the new franchise agreement to be entered into with Best Franchising, Inc. ("Best"). What is disclosed is that a "Signing Payment" of $530,000.00 must be repaid over seven years if the franchise agreement is terminated. *See* Disclosure Statement at 14. Since no specific information is

[6] Compare and contrast, for example, the wire transfer for the "FF&E replacement" under the existing Cash Collateral Stipulations and Orders. Attached hereto as Exhibit "2", and specifically pages 2-12 and 2-13, shows the wire transfers to the

provided about the terms of the new franchise agreement, it is impossible to assess the impact of a termination of the franchise agreement during the Plan period. Will it be terminable by the franchisor, without cause, during the course of the seven year payment under the Plan? If so, what will the impact be on creditor recoveries if another $530,000.00 must be repaid (at $75,714.00 per year for seven years)? The Debtor must disclose the risks of a termination of the franchise agreement, and further disclose all material terms of that agreement.

3. The Disclosure Statement's Projections Are Misleading In Five Respects And Must Be Supplemented.

The Disclosure Statement contains seven year projections for the hotels which will be retained. Those hotels and their cashflows provide the sole basis for payments under the Plan. *See* Disclosure Statement at 13 and Exhibit "E". Those projections are faulty in at least five (5) respects and must be revised. Failure to revise and adequately correct these defects will result in a misleading disclosure statement with creditors not having adequate information.

(a) The 1999 Figures Should Be Stated As Actual And Not Projected.

The existing Exhibit "E" shows 1999 projected operating results. By the time this Disclosure Statement is up for approval, the Debtor will have actual numbers for the hotels, and therefore the projections should set forth the 1999 numbers as actual and not projected.

(b) The Debtor Must Disclose And Specifically Set Forth All Assumptions For The Projections.

The Debtor's Disclosure Statement states that "these projections are based on historical performance of the Hotels and the assumptions outlined in the [Exhibit "E"]." *See* Disclosure Statement at 13. ***In fact, the projections in Exhibit "E" do not contain a single assumption.*** This Debtor must state, with specificity, all assumptions upon which it is relying with respect to these projections.

Secured Lender specifically from the Debtor (*i.e.* Leeward Hotels, LP), and not the various limited partners or general partner as was the case with the prepetition payments (pages 2-1 through 2-11).

This is not an academic point. As set forth in Exhibit "1" hereto, the primary source for repayment for unsecured creditors (including the Secured Lender's unsecured claim in Class 3-B) is from "net cashflow" from the hotels. The Debtor provides seven year projections without stating a single assumption, yet shows a positive change in "net cash" for the eight retained hotels between 1999 and 2000 of nearly $818,000.00 per year. *See* Exhibit "1". It is impossible to review these projections and have any idea as to why the Debtor would project this material change in net cashflow because the Debtor does not provide any of the assumptions upon which it bases its projections. This is even more important when one considers that Mr. Kilburg, when reviewing these very hotels as a vice president at Samoth prior to acquiring the hotels, advised Samoth not to purchase these hotels because of his belief that there were substantial deferred maintenance expenses associated with the hotels, and that they were in highly competitive markets. *See* discussion in Section IV(6)(a) at page 30, *infra*.

(c) The Projections Materially Understate The Total Secured Lender's Secured And Unsecured Claims.

The projections materially understate the total Lennar secured claim (for Class 2-N) as well as the total Lennar unsecured claim (in Class 3-B). Specifically, notwithstanding having the detailed breakdown of all of the loans set forth in the "Secured Lenders: (1) Objection To The Use Of Cash Collateral; (2) Notice Of Nonconsent To The Use Of Cash Collateral; (3) Alternatively, Request For Imposition Of Conditions On The Use Of Cash Collateral; and (4) Other Appropriate Relief" filed on August 3, 1999 (which was supported by all of the underlying loan and security documents in the contemporaneously filed "Appendix Of Exhibits Filed By Secured Lender In Support Of Various Pleadings"), which sets forth with specificity that the total loans of the Secured Lender are in excess of $24.5 million, the Disclosure Statement inexplicably states that the total loans to the Secured Lender are approximately $22.2 million. *See* Disclosure Statement at 6-7. Accordingly, the Disclosure Statement (and accompanying projections) understate the total Secured Lender's claim by approximately $2.3

million. *See also*, "Proofs Of Claim" with respect to all of the loans filed by the Secured Lender on January 3, 1999. Moreover, the Disclosure Statement is deficient in further respects as follows:

(i) The Secured Lender's Deficiency Claim Is Understated. The Disclosure Statement provides appraised values with respect to the ten (10) hotels upon which the Secured Lender has liens. *See* Disclosure Statement at 7. The Plan calls for a return of the Dallas, Las Cruces and Round Rock hotels to the Secured Lender. The Debtor's Disclosure Statement and Plan provide for a "credit" against the claims of the Secured Lender, not for the acknowledged appraised values of the three returned hotels, but rather with respect to the Dallas hotel and the Round Rock hotel, a "credit" of $4.7 million for Dallas (compared with an appraised value of $2.7 million) and a $1.6 million for Round Rock (contrasted with an appraised value of $1.2 million). The bases for the inflated "credit" are "offers to purchase" the Round Rock and Dallas hotels for these amounts. The Disclosure Statement does not contain copies of these offers, nor does the Disclosure Statement reveal that the "offers" are in fact non-cash offers which contain a minimal down payment (8% in the case of the Dallas property, and 12% in the case of Round Rock) and then require an assumption of the Secured Lender's debt. The Secured Lender has affirmatively gone on record in this case as saying it will not consent to the assumption of its debt with respect to these properties.[7] Notwithstanding that, the Debtor uses an inflated "credit" based upon non-cash offers for these hotels. The Debtor's projections must not and should not take into account non-cash offers for these hotels for purposes of determining the Secured Lender's unsecured Class 3-B claim, but rather the

[7] *See* "Notice Of Secured Lender Of Objection To Any Assumption Of Indebtedness In Connection With Sales" filed on October 13, 1999.

acknowledged appraised values with respect to these returned hotels.[8] In addition, to the extent that the Debtor wishes to use these "offers" to inflate the credit against a secured debt, the Debtor must attach copies of these "offers" to the Disclosure Statement so that all parties can determine whether these are, in fact, cash equivalents with respect to these hotels.

(ii) The Secured Lender's Allowed Secured Claim Is Also Understated.

The Debtor's Disclosure Statement, Plan and projections assume that the Secured Lender has an allowed secured claim of $13.7 million. This is erroneous for four (4) reasons. First, it is based upon the Debtor's faulty assumption that the total claim on the petition date is $22.2 million (and not the $24.5 million as specifically asserted in these cases), and further that the amount of the "credit" to the Secured Lender as a result of the return of the three hotels would be the equivalent of $7.6 million and not their appraised value of $5.2 million. When the appraised values are used, the Secured Lender's allowed secured claims do not total $13.6 million as set forth in the Disclosure Statement, but rather $14.2 million based upon the Debtor's assumption of value with respect to the retained hotels encumbered by the Secured Lender. Moreover, the Secured Lender's unsecured claim will be subject to the prepayment yield maintenance provisions of the loan documents.

Second, pursuant to the terms of the Stipulated Cash Collateral Orders, the Debtor is required to segregate net cashflows with respect to the hotels encumbered by the Secured Lender. Pursuant to the weekly operating reports provided to the Secured

[8] Moreover, even the Debtor cannot believe these inflated credits are warranted. In setting forth "Release Prices" in Exhibit "H" to the Disclosure Statement, the Debtor proposed a "Release Price" of $3.9 million for the Dallas hotel, not a $4.7 million amount. In short, there is no internal consistency even in the Disclosure Statement.

Lender by the Debtor for the week ending December 20, 1999, the cash balance in these Cash Collateral Accounts was $357,698.70. In the Ninth Circuit, in determining an allowed secured claim, the value of accumulated cash collateral must be utilized for purposes of calculating an allowed secured claim. *See In re Ambanc La Mesa Limited Partnership*, 115 F.3d 650, 654 (9th Cir. 1996).[9] As such, the Debtor's projections must be revised to show what the amount of the allowed secured claim is with respect to the Secured Lender taking into account the cash collateral accounts.

Third, it fails to take into account that the Secured Lender has junior liens on all properties. For example, the Secured Lender's allowed secured claim on the Abilene Holiday Inn, Leavenworth and Plainview hotels consists of its first lien *and* a portion (up to the value of the hotel, as per the Disclosure Statement) of the second lien position. *See* Exhibit "4".

Fourth, the Secured Lender has made its election pursuant to Bankruptcy Code § 1111(b)(2) with respect to the "Ottawa Loan," the "Olathe Loan," and the "Liberty Loan" to be treated as fully secured with respect to those three hotels and three loans.[10] The Debtor must account for the impact on the Secured Lender's secured claim with

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[9] As the Ninth Circuit stated in *Ambanc*:

> ***The value of [the secured lender's] secured claim for the purposes of confirmation is the market value of real property plus the net amounts of the rents collected postpetition and preconfirmation and subject to a deed of trust and assignment of rents***. Thus, [the secured lender] should have been paid on its secured claim of approximately $4.6 million—$4.3 million in the value of the real property and the estimated $300,000.00 accumulated cash collateral by the time of the effective date. The Bankruptcy Court erred in finding the $4.3 million valuation of [the secured lender's] secured claim satisfied the cramdown requirements.

Ambanc, 115 F.3d at 654 (emphasis added).

[10] *See* "Secured Lender's Election Pursuant To Bankruptcy Code § 1111(b)(2) (Ottawa Loan)"; the "Secured Lender's Election Pursuant To Bankruptcy Code § 1111(b)(2) (Olathe Loan)"; and the "Secured Lender's Election Pursuant To Bankruptcy Code § 1111(b)(2) (Liberty Loan)," all filed on January 3, 2000.

respect to the payments that will be due and payable on these three hotels (including if sales are consummated for the "Release Prices"), and further the amount of the "allowed secured claims" for cramdown purposes with respect to the values of the hotels and the cash collateral accounts.

(d) Future Value Of Hotels.

A material part of the projections will be the future values of the hotels. For example, the Disclosure Statement in its cash flow projections (Exhibit "E") assumes that the Albuquerque Hotel (which the Debtor states without support is "in excess of $3 million"—*see* Disclosure Statement at 8), will be sold by yearend 2001 and produce $1 million in sales proceeds over and above the Amresco debt of approximately $2.5 million. *See* Exhibit "E". The Debtor provides no rationale or explanation as to why it believes that this hotel will sell for approximately $3.5 million in 2001, which sale price is material with respect to the cashflows under the Plan since it is projected to contribute $1 million for creditors.

Moreover, a material part of repayment of the Secured Lender's secured claim will be a balloon payment which will come due presumably by yearend 2007 (assuming sales are not consummated for "Release Prices"). While the Debtor has not set forth what it believes the value of the hotels will be in the year 2007, the Disclosure Statement merely states: "By the Maturity Date of the Plan, the Debtor will sell or refinance the Lennar Hotels." *See* Disclosure Statement at 15. There is not a single risk factor disclosed, nor is there any basis at all upon which the Secured Lender can intelligently determine whether or not there is any reasonable possibility that the Debtor will be able to sell or refinance these hotels for the amount of the balloon payment. As such, the Disclosure Statement must state, with specificity, what the Debtor believes the values will be by calendar yearend 2007 when this potential sale or refinance will occur, and the specific basis for that opinion.

Moreover, and equally distressing, there is no discussion as to how the "Release Price" provisions of the Plan intersect with the balloon payments that will come due by calendar year 2007. In fact, the Disclosure Statement is directly inconsistent on this point. ***The Disclosure Statement provides that even using the Debtor's understated allowed secured claim for the Secured Lender, by calendar yearend 2007, the balance due and owing on the Secured Lender's secured claim of Class 2-N is $12.4 million. If the Debtor arranges a sale for the Release Prices for the seven remaining hotels as set forth on Exhibit "H", those sales will produce gross proceeds of $11,967,333.44. See Exhibit "3" attached hereto.*** This does not even take into account the additional amounts which will be due based on the yield maintenance prepayment provisions of the applicable loan documents. Accordingly, while the Debtor's Disclosure Statement talks in terms of a payment in full of the Secured Lender's secured claim by some sort of nebulous future sale or refinance, the Disclosure Statement also provides a set of Release Prices that simple math indicates will not be sufficient to do so (even at the understated secured claim of the Secured Lender, and certainly not taking into account the § 1111(b) elections made with respect to the Olathe, Ottawa and Liberty Loans).

At a minimum, this Debtor's Disclosure Statement must set forth, with specificity, what the balloon payments will be with respect to the secured claims of the Secured Lender, what it anticipates the value of the hotels will be at the maturity date of the Plan in 2007 (and the specific basis for that belief), what risk factors are inherent with respect to the payoff of that balloon payment, and what impact a sale at the Release Prices will have with respect to those balloon payments.

(e) <u>The Projections Do Not Properly Account For An Allocation Of The Secured Lender's Allowed Secured Claim On A Hotel By Hotel Basis</u>.

The Projections are misleading in that they show an aggregate debt service with respect to the Secured Lender's allowed secured claim (which, again, is materially understated), and further shows a debt service on a hotel by hotel basis without showing what the amount of the allowed secured claim on

each of those hotels is. The Secured Lender has filed its "Motion Under Bankruptcy Rule 3013 For Determination For Propriety Of Classification" on November 24, 1999 (the "Classification Motion"), which is set for hearing on January 10, 2000. The Disclosure Statement and Plan do not allocate the Secured lender's allowed secured claims on a loan by loan, hotel by hotel basis. As such, it is difficult to understand on a hotel by hotel basis what the balloon payment will be in the year 2007 when the hotels are going to be subject to sale or refinancing. This is, of course, related to the Secured Lender's Classification Motion.

The Disclosure Statement and projections must show, with specificity: (i) what the allowed secured claim against each hotel is; (ii) what the balloon payment will be on a hotel by hotel basis (with respect to the Secured Lender's allowed claim as against that hotel); (iii) what the balloon payment will be with respect to the three hotels on which the Secured Lender has exercised its Bankruptcy Code § 1111(b)(2) rights; and (iv) what the impact of a sale will be if the sale is consummated at the stated "Release Price" as set forth in the Disclosure Statement at any time during the seven year life of the Plan. In other words, are the "Release Prices" sufficient to pay off the lien claims and/or balloon payments for the outstanding balances on those hotels? It is impossible to tell from the Disclosure Statement or projections. By the Secured Lender's calculations, if the Debtor makes all payments due under the Plan for the full seven years, the Release Prices will be insufficient to make the required balloon payment in 2007 on all but two of the hotels. See Exhibit "4" attached hereto. See *also* discussion in Section IV(4), below, relating to the Release Price provisions in the Plan and Disclosure Statement.

4. The Disclosure Statement Is Misleading And Contradictory With Respect To The "Release Prices" And Post-Confirmation Sales Provisions.

The Disclosure Statement and Plan are inherently inconsistent and confusing. While the Disclosure Statement and Plan state that the allowed secured claim of the Secured Lender secured by the

seven retained hotels will be paid out over the seven year life of a Plan (with a fairly large balloon payment by calendar yearend 2007), the Disclosure Statement states (in an almost offhanded manner): "Debtor shall be permitted to sell without further Court approval any of the Lennar Hotels during the term of the Plan, so long as the sales price will result in the payment to Lennar of the Release Price identified in Exhibit "H". Lennar shall be required to release its lien interest in any individual hotel upon payment of the Release Price. By the Maturity Date of the Plan (defined as a date seven years after the effective date or calendar yearend 2007), [the debtor] will sell or refinance the Lennar Hotels." *See* Disclosure Statement at 14-15.

(a) <u>There Is No Disclosure As To How The Release Prices Were Calculated</u>.

There is no discussion or disclosure in the Disclosure Statement as to how the Release Price provisions were arrived at. As set forth in Exhibit "3" attached hereto, with respect to five of the seven hotels the Release Price is less than what the Debtor estimated was the fair market value in the Disclosure Statement.[11] The Debtor must disclose how the Release Prices were calculated and arrived at, and why the Release Prices on at least five of the seven retained hotels are lower than the fair market value of those hotels.

(b) <u>Why Are Release Prices Provided For 3 Hotels Being Returned To The Secured Lender</u>?

Moreover, it is unclear why the Disclosure Statement (Exhibit "H") contains Release Price provisions for three hotels that will be returned to the Secured Lender on the effective date of the Plan (*i.e.* the Disclosure Statement provides Release Prices for the Dallas, Round Rock and Las Cruces properties, yet all of those properties are going to be returned to the Secured Lender under the terms of

[11] The fair market value set forth in the Disclosure Statement on page 7 lists the combined fair market value of the seven hotels at $14.2 million. Inexplicably, the "Release Price" for those same seven hotels totals approximately $12 million. *See* Exhibit "3". With respect to all but the Olathe and Ottawa hotels, the Release Price is less than the fair market value of the hotel.

the Plan). The Debtor provides no explanation or disclosure as to why those Release Prices are contained in the Disclosure Statement.

(c) <u>What Is The Impact On Creditors If Sales Are Consummated At Release Prices</u>?

The Disclosure Statement also provides no discussion as to what the impact will be on the Projections and the recovery to both unsecured creditors and the Secured Lender if indeed one or any of the hotels is sold for the scheduled "Release Price." The only source of payments under this Plan are the hotel cashflows. Indeed, if one year after confirmation the Debtor were in fact able to negotiate cash sales for all seven hotels at the Release Price (of approximately $12 million total), presumably the impact on the Plan would be that not only would unsecured creditors which were to be paid from the net cashflows of these hotels be left without any recovery, but presumably even under the Debtor's calculation of the "balloon payment" due to the Secured Lender at the end of 2007 of approximately $12.4 million that the Secured Lender would not be paid that amount as well.[12] The Debtor needs to disclose this possibility and the economic consequences of such a sale.

(d) <u>What Impact Will The Release Prices Have On The Best Franchising Loan</u>?

A material part of the Plan is a $530,000.00 loan by Best Franchising secured by a junior lien on six of the Secured Lender's seven hotels. *See* Disclosure Statement at 14; Exhibit "G" thereto. What impact will sales for the Release Prices have on the Best Franchising debt and its junior lien position?

(e) <u>What, If Any, Are The Secured Lender's Credit Bid Rights</u>?

Finally, the Disclosure Statement and Plan are unclear as to whether the Secured Lender will have any credit bid rights under Bankruptcy Code § 363(k). Presumably the sales being discussed in the Disclosure Statement and Plan are sales free and clear of the Secured Lender's lien. It is unclear if the

[12] Indeed, by the Secured Lender's calculation, the "balloon payment" with respect to its Class 2-N claim would be approximately $13.6 million resulting in a shortfall of over $1.6 million. The Disclosure Statement needs to discuss what would happen in this event. *See* Exhibit "4".

Secured Lender is being afforded credit bid rights or not. The Disclosure Statement and Plan need to clarify this.

5. The Disclosure Statement Must Provide More Disclosure On Classification And Reasons For Disparate Treatment.

(a) The Disclosure Statement Needs To Disclose The Basis For Classification Of Claims.

The Disclosure Statement and Plan provide that the ten separate loans held by the Secured Lender are to be treated as one single class (Class 2-N). While the Secured Lender's Classification Motion is pending, the Disclosure Statement needs to explain the classification of the Secured Lender's claim as one claim and the basis therefore in light of the separate notes, deeds of trust, and other lien and security documents. *See* Classification Motion.

(b) The Disclosure Statement Needs To Disclose The Basis For Subordination Of The Secured Lender's Unsecured Claim.

Moreover, the Disclosure Statement needs to disclose on what basis (factual or otherwise) the Debtor is subordinating the Secured Lender's unsecured claim (Class 3-B), and also the Rejection Claims and Abandoned Hotel Claims (Classes 3-D and 3-E) to the Trade Claims (Class 3-A). The Plan and Disclosure Statement specifically provide that Trade Claims are to be paid first from Net Cashflows and only when they are fully paid will the Secured Creditor's unsecured claim (Class 3-B) receive any distribution from Net Cashflows. Moreover, the Disclosure Statement provides that the Rejection Claims and Abandoned Hotel Claims are also to receive no payment from Net Cashflows, but may only look to the Preference Recovery Pool for payments. This is clearly disparate treatment, and effectuates a subordination of these claims to the Trade Claims. The Debtor's Disclosure Statement provides no basis for such disparate treatment or subordination.

The Disclosure Statement must provide the basis (factual or otherwise) for the provisions precluding the Secured Creditor's unsecured Class 3-B claim from sharing in alleged preference

recoveries. Under the Disclosure Statement and Plan, if the Debtor were successful in recovering any or all preferences from the Secured Lender (which is doubtful—*see* discussion in Section IV(2)(d) at page 15, *supra*), the Secured Lender would not have the right to participate in its *pro rata* portion of the Preference Recovery Pool. Again, this is related to a type of disparate treatment and subordination, the basis for which is not disclosed or even discussed.

(c) The Disclosure Statement Needs To Disclose The Basis For Less Favorable Interest Rates To The Secured Lender Than To Amresco.

The Disclosure Statement needs to provide disclosure as to why the Secured Lender's secured claims (Class 2-N) are provided a lower interest rate (9.75%) than Amresco's secured claim (Class 2-O) (which receives 10.25%). Moreover, there is no discussion in the Disclosure Statement as to why the Amresco secured claim will be paid in full by calendar yearend 2000 or, at the latest, calendar yearend 2001, while the seven retained hotels acting as collateral for the Secured Lender's Class 2-N claim are held for seven years. The interest rate disparity is of interest because the Debtor asserts that the Amresco Class 2-O claim is over-secured, yet it receives a higher interest rate than the Secured Lender's claims (some of which may be under secured based on the Debtor's valuations). Moreover, there is certainly more risk with respect to the retained hotels of the Secured Lender, yet the Secured Lender is paid a lower interest rate. There is no discussion as to how this interest rate was arrived at, or why there is this disparate treatment.

6. The Disclosure Statement Must More Accurately And Fully Disclose Pre-Bankruptcy Events.

The Disclosure Statement's discussion of the "History And Operation Of The Debtor" and "Pre-Bankruptcy Events" is incomplete and materially misleading. Moreover, and amazingly, the Disclosure Statement goes into pre-bankruptcy settlement discussions between the Secured Lender and Mr. Kilburg which were conducted pursuant to and in accordance with Federal Rule of Evidence 408. *See*

Disclosure Statement at 8-9 (discussions of terms of prebankruptcy workout negotiations and alleged "agreements" of the Secured Lender). Notwithstanding that, the Disclosure Statement goes through pre-bankruptcy settlement discussions and makes materially inaccurate statements with respect to what transpired in those discussions. If the Debtor wishes to engage in this exercise, then the Disclosure Statement must have the complete story.

The Disclosure Statement must be supplemented to include at least the following:

(a) Acquisition By Kilburg Of His Interest In This Debtor And The Hotels.

(i) The Debtor is an Arizona limited partnership formed on February 2, 1999 for the sole purpose of allowing the principal, William Kilburg, to consolidate in one entity a number of hotel purchases. *See* "Status Report" filed by the Debtor on September 3, 1999 at page 1 (the "Status Report").

(ii) The general partner of the Debtor is Kilburg Hotels, LLC ("Kilburg Hotels"). Kilburg Hotels was itself only formed on January 29, 1999. Kilburg Hotels had no assets when it was formed, and it was formed for the sole purpose of holding the interests of the various hotels currently owned by the Debtor. *See* Bankruptcy Rule 2004 Examination Transcript of William J. Kilburg taken September 29, 1999 (hereinafter "Kilburg Tr. at ____") at 22:25 through 23:20. True and correct copies of the Kilburg Transcript excerpts referenced herein are attached hereto as Exhibit "5". The only members of Kilburg Hotels are Kilburg and his wife, Karin. *See* Status Report, Exhibit "A".

(iii) The Debtor, and Kilburg, put no out of pocket equity money at risk in the acquisition of any of the partnerships that own the hotels. *See* Kilburg Tr. at 150:22 through 153:4.

(iv) Kilburg became aware of the acquisition opportunity for the hotels because he was an officer (an Executive Vice President) of Samoth USA, Inc. ("Samoth") and was analyzing these hotels for possible acquisition by Samoth. *See* Kilburg Tr. at 10:10-16 through 12:7. In his capacity as an officer of Samoth, he advised Samoth not to purchase the hotels because they faced "significant competition" and some required "substantial renovation." *Id.* at 12:23 through 13:11.

(v) Kilburg left Samoth on January 30, 1999 for the purpose of acquiring the very hotels he had advised Samoth were not good investments. *Id.* at 16:5-18. He acquired the entities that own the hotels for no out-of-pocket, at-risk capital. *See* Kilburg Tr. at 150:22 through 153:4.

(vi) With respect to all of the entities that are currently the general partner and limited partners of this Debtor, the Mr. and Mrs. Kilburg are the sole ultimate equity owners. *See* Status Report, Exhibit "A" thereto.

(vii) Prior to the acquisition of the hotels by this Debtor in April, 1999, this Debtor had no assets nor did it have any liabilities. It was, in all respects, a shell entity created for the very purpose of obtaining title to these hotels. *See* Kilburg Tr. at 23:11-16. Moreover, the Debtor has no employees. *See* Kilburg Tr. at 88:7 through 89:1.

(b) <u>The Prebankruptcy Workout Negotiations</u>.

(i) When Kilburg acquired his interest in the general partner of this current Debtor (and prior to the actual formation of the current Debtor), the Secured Lender's loans were in default. In this regard, Mr. Kilburg immediately entered into workout negotiations with the Secured Lender on February 10, 1999. *See* Exhibit "6-1" attached hereto.

(ii) Mr. Kilburg agreed and acknowledged when he was negotiating with the Secured Lender in February, 1999 that the Secured Lender did not consent to his acquisition of the interests in Kilburg Hotels, and moreover was told that that acquisition was not done in compliance with the terms of the applicable loan and security documents. *See* Exhibit "6-2".

(iii) The Secured Lender was negotiating with Kilburg Hotels and Mr. Kilburg in his individual capacity, and in fact the law firm of Hebert Schenk & Johnsen was representing both Kilburg Hotels and Mr. Kilburg, in his individual capacity. *See* Exhibit "6-3" (letter of March 31, 1999).

(iv) Notwithstanding ostensibly forming the Debtor partnership and transferring the hotels in March and April, 1999, Kilburg Hotels and Mr. Kilburg continued to negotiate with the Secured Lender without formal disclosure that they had created the Debtor entity and indeed transferred the properties. *See* Exhibit "6-3" and Exhibit "6-4".

(v) During the course of the settlement negotiations, Mr. Kilburg made it very clear both that he would not personally guaranty any obligations to the Secured Lender (*see* Exhibit "6-5" at paragraph 2, page 1), and moreover he would not agree to any reduction in the management fee for Kilburg Management (the company that he owned). *Id.* at Paragraph (f), page 3.

(c) <u>Transfer Of The Hotels To The Debtor</u>.

(i) Contrary to the suggestions in the Disclosure Statement that the Secured Lender consented to the transfer of the hotels to the Debtor in April, 1999, this is incorrect. *See* Disclosure Statement at 9. In fact, the Secured Lender was not informed

by Mr. Kilburg's counsel (John J. Hebert, Esq.) until May, 1999 that the hotels had been transferred, and even then the Secured Lender was not specifically told the name of the entity or entities to whom the transfers were made. Upon learning of the transfer, on May 26, 1999, counsel for the Secured Lender put Mr. Hebert on notice that it did not consent to the transfer, and further that the transfer was a default under the applicable loan and security documents. *See* Exhibit "6-7" attached hereto. Moreover, notwithstanding numerous requests to get information regarding the specific documents evidencing the transfer of the properties, Arizona counsel for the Secured Lender was told that the documents had been sent to Miami counsel for the Secured Lender. Miami counsel for the Secured Lender (Laurel Isicoff) had not been sent the documents, and sent a letter to Mr. Hebert on July 28, 1999 specifically stating she had not received any of the documents notwithstanding her requests. *See* Exhibit "6-8". Indeed, the first time the Secured Lender saw any of the documents evidencing the transfers to the Debtor entity was when documents were hand-delivered on July 28, 1999—*i.e.* five days before the filing of the Chapter 11 bankruptcy cases. *See* Exhibit "6-9".

(d) <u>Management Of The Hotels</u>.

(i) The hotels are currently managed by Kilburg Management, LLC ("Kilburg Management") an entity also directly controlled by Mr. Kilburg and his wife. *See* Status Report at 2:20-23. Like Kilburg Hotels, Kilburg Management was formed at the same time (January 29, 1999), and also had no assets at all at the time of its formation. *See* Kilburg Tr. at 23:17 through 24:8. The sole purpose of forming Kilburg Management was to act as the "management arm" of Kilburg Hotels. *See* Kilburg Tr. at 24:9-15.

(ii) The ten year management contract with Kilburg Management was entered into in February, 1999, and ties up management of these properties for a ten year period. Mr. Kilburg acknowledged that at no time did he shop around to determine if another, third-party management, could do this less expensively, nor did he ever have any intention of having any third party manage these hotels. *See* Kilburg Tr. at 99:20 through 100:9.

(iii) The Disclosure Statement states that "Lennar agreed to accept Kilburg's credentials and agreed that it would restructure and modify the payment terms" of the various loans. *See* Disclosure Statement at 8. In fact, the Secured Lender has never accepted "Kilburg's credentials," and does not to this day. In fact, a point of contention throughout the pre-bankruptcy negotiations was Mr. Kilburg's insistence that he retain a management contract with a two-year "out" essentially giving him two years management fees even if he were terminated prior to that time. For example, as recently as July 30, 1999 (the Friday before the Monday bankruptcy filing), Mr. Kilburg was insisting on his management contract and moreover refused to reduce the management fees to be charged thereunder. *See* exchange of e-mails between Secured Lender and Mr. Kilburg dated July 30, 1999 attached hereto as Exhibit "6-10". Specifically Mr. Kilburg stated that even though the Secured Lender could obtain a management contract at lower than Kilburg Management, Mr. Kilburg betrayed that his real interest in this case is the preservation of the management contract as follows:

> This management contract is a fairly special circumstance and the terms we discussed should reflect the rights that I am giving up a a [sic] part of the deal, [sic] ***Attempting to conform this to an independent third party deal that may have been "ground down" by your REO Department will not work for me.*** As we discussed, by going down this path I am attempting to be reasonable and avoid a situation that is bad for

everybody. ***I am not, however, prepared to completely capitulate and accept a deal not in my interest.***

See Exhibit "6-10" (July 30, 1999 e-mail from William Kilburg to Stephen Buckley at 12:57 p.m.) (emphasis added).

(e) Terms Of The Prebankruptcy Restructure.

(i) With respect to the Disclosure Statement about the Secured Lender's purported "agreement" for a restructuring of the debt (*see* Disclosure Statement at 8-9), indeed those discussions revolved around a third party (DLJ) agreeing to make a full equity infusion in the amount of $1.4 million. Indeed, on February 18, 1999, Kilburg Hotels (the current general partner of this Debtor) made a specific proposal to DLJ for a capital infusion of $1.4 million. *See* Exhibit "6-11". In fact, DLJ declined to make the $1.4 million equity infusion as set forth in Mr. Kilburg's proposal (apparently not believing that the hotels were a good investment).

(ii) Notwithstanding the verified statements filed by the Debtor's counsel in this matter when it was retained, the Debtor's counsel has never disclosed that it represented Mr. Kilburg individually in the negotiations involving settlement of the Secured Lender's loans, as well as presumably as a principal of Kilburg Management in attempting to negotiate the management contract. *See* Exhibit "6-6" paragraph F at page 3. The verified statements filed when Debtor's counsel was retained only indicate that the law firm of Hebert Schenk & Johnsen represented Kilburg Hotels in matters "unrelated" to these loans. That is a material inaccuracy given the clear nature of documentation and settlement discussions that occurred in these cases.

7. <u>The Disclosure Statement Must More Accurately Disclose The Full Terms And Conditions Of The So-Called "Capital Infusion"</u>.

The Disclosure Statement provides that there will be a "capital infusion" of $530,000.00. *See* Disclosure Statement at 14. *See also* Exhibit "G" to the Disclosure Statement. As set forth in prior sections, the Debtor needs to disclose that this is a loan which may need to be repaid. *See, e.g.*, Section II(2) at page 7, *supra*. The Disclosure Statement is deficient, however, in another respect with respect to the so-called "capital infusion." Specifically, the Exhibit "G" (which is the October 22, 1999 "deal point" letter with Best Franchising) is inconsistent with the rest of the Plan and Disclosure Statement in the following areas:

(a) Exhibit "G" lists the Lubbock Hotel as one of the hotels that would be "reflagged." *See* Exhibit "G", page 1. This is the same hotel that the GMAC settlement is giving back to GMAC.

(b) The "capital infusion" in this case is an amount going from Best Franchising to Kilburg Hotels which is then going to be secured by a junior lien on the various hotels. The Disclosure Statement does not state why that money would go to Kilburg Hotels instead of the Debtor when it is the Debtor that is obligated to repay it.

(c) Best Franchising is going to require that the Debtor enter into a franchise agreement as part of this so-called "capital infusion." There is no disclosure as to what the fees and other costs would be with respect to that franchise agreement, rather just general references to "liquidated damages and all other applicable fees under the franchise agreements." *See* Exhibit "G" at 2. The Debtor should disclose what the specific terms of the franchise agreement will be, and how those have been worked in to its projections. *See also* discussion of risk factors at Section IV(2) at page 13, *supra*.

(d) Exhibit "G" references the fact that Best Franchising will receive a junior lien on the Albuquerque Hotel (currently encumbered by Amresco), as well as the Round Rock, Las Cruces and Dallas Hotels encumbered by the Secured Lender (*see* Exhibit "G" at 3). The Disclosure Statement also states that the Round Rock, Las Cruces and Dallas Hotels will be returned to the Secured Lender on the effective date of the Plan. What is the impact of this on the Best Franchising loan?

(e) Exhibit "G" states that "It is anticipated that the current ownership structure [of the Debtor] would be collapsed and streamlined concurrent with this transaction." Exhibit "G" at 2. There is nothing in the Plan which provides for this "collapsing" and "streamlining." The Debtor must disclose what it intends to do with respect to this since these are not set forth in the Plan or Disclosure Statement.

(f) Finally, there is no disclosure in the Plan with respect to how the "Release Prices" impact with the junior security interests being given to Best Franchising under the terms of the "capital infusion." The Disclosure Statement must set forth, with specificity, how a sale for the "Release Prices" would impact the junior lien positions of Best Franchising.

8. <u>The Disclosure Statement Must Disclose More Information About The Kilburg Management Contract</u>.

Finally, Exhibit "I" to the Disclosure Statement lists the various executory contracts that are going to be assumed as part of the confirmation. The Disclosure Statement must provide the following:

(a) Why is the Debtor assuming the Kilburg Management management contract on the Dallas, Las Cruces and Round Rock Hotels when these hotels would be returned to the Secured Lender? Will the Secured Lender then be taking these hotels subject to the Kilburg Management ten year management contract? If not, will Kilburg Management be submitting a claim based upon the post-confirmation termination of that management contract as to those three properties? The contract has a two (2) year liquidated damages clause.

(b) The Debtor must disclose what efforts it made to "shop" the management contract to determine if it were the best management contract available. As set forth in Section IV(6)(d), the Secured Lender had a replacement management company that would have managed the hotels for a lower amount. The Debtor must disclose whether the Kilburg Management management contract is the best available economically, and the basis thereof. Obviously, as part of this the Debtor needs to disclose the relationship between Kilburg Management, the Debtor, and Hebert, Schenk & Johnsen as prior counsel for Mr. Kilburg.

(c) The Disclosure Statement provides that the Albuquerque hotel will be sold by either yearend 2000 or 2001. The Kilburg Management contract has been assumed for that hotel. *See* Exhibit "I". The contract has a 2 year liquidated damages provision. Will this create a post confirmation claim against the reorganized Debtor?

V. CONCLUSION AND RELIEF REQUESTED.

For all the foregoing reasons, the Secured Lender respectfully requests that the Court deny approval of this Disclosure Statement, and require that the Debtor supplement in accordance with this Objection.

RESPECTFULLY SUBMITTED this 3rd day of January, 2000.

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ATTACHMENTS TOO VOLUMINOUS TO FILE ELECTRONICALLY

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